

HIGHLIGHTS from Chapter 3:

Global Economy: Heading into a Decade of Disappointments?

Key Points

- *The COVID-19 pandemic has caused major disruptions in the global economy. Uncertainty about the post-pandemic economic landscape and policies has discouraged investment and trade; education disruptions have slowed human capital accumulation.*
- *The pandemic is likely to steepen the projected slowdown in growth of global potential output—the level of output the global economy can sustain at full employment and capacity—over the next decade. If history is any guide, the global economy is heading for a decade of growth disappointments.*
- *A comprehensive policy effort is needed to reverse the damage of the pandemic and rekindle robust, sustainable, and equitable growth. In the context of weak fiscal positions and elevated debt, institutional reforms to spur growth are particularly important. In the past, the growth dividends from reform efforts were recognized by investors in upgrades to their long-term growth expectations.*

Damage from the pandemic for long-term growth prospects. Even before the pandemic, trends in fundamental drivers of growth suggested that annual average potential growth would slow by another 0.4 percentage point globally and 1 percentage point in EMDEs over the 2020s (**Figure 1**). As a result of the disruptions caused by the pandemic, the slowdown in potential growth over the next decade may be 0.3 and 0.6 percentage point per year steeper for the global economy and EMDEs, respectively, than anticipated before the pandemic—unless decisive policy action is taken or major technological advances materialize.

Prospect of a decade of growth disappointments. Past recessions were followed by several years of disappointing growth outcomes and downgrades of long-term growth expectations. After the 2008 global financial crisis, long-term global growth expectations were repeatedly downgraded, to 2.4 percent in 2019, 0.9 percentage point below their 2008 rate. Five years after country-specific recessions, long-term growth expectations were typically 1.5 percentage points lower cumulatively than in countries without recessions.

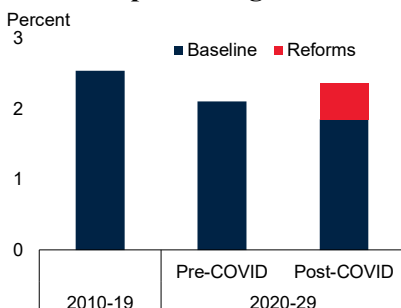
Reforms to boost growth prospects. A comprehensive policy effort is needed for a recovery that reverses the damage from the pandemic and builds back better. Such an effort would include reforms to improve governance and business climates, encourage productivity-enhancing investment in human and physical capital, foster economic flexibility, and diversify economies where activity is concentrated in a few sectors. If every country repeated its best ten-year improvement in investment and schooling and managed to close the gap between male and female labor force participation rates by as much as the most successful quartile of reformers, the adverse impact of the pandemic on EMDE potential growth could be reversed. Stimulus packages to support the recovery can be an opportunity to invest into climate resilience. Of particular priority at the current juncture, when fiscal positions have been extremely stretched by the policy response to the pandemic, are institutional reform initiatives, which have been associated with increased investment. In the past, investors have recognized institutional reform efforts, raising their long-term growth expectations by 0.8 percentage point, on average, five years after the reforms.

Global Economic Prospects

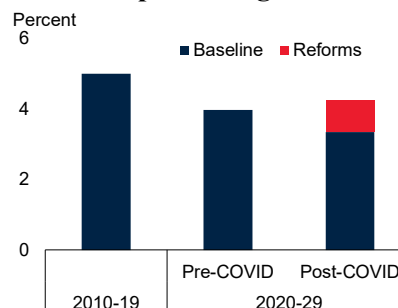
Figure 1. Implications of the COVID-19 pandemic for global growth prospects

The pandemic is likely to steepen the projected slowdown in growth of global and EMDE potential output—the level of output the global economy can sustain at full employment and capacity—over the next decade, although a comprehensive reform effort may partly stem this slowdown. If history is any guide, the global economy is heading for a decade of growth disappointments, with lasting output losses and a modest recovery in investment. In the past, the growth dividends from reform efforts were recognized by investors in upgrades to their long-term growth expectations.

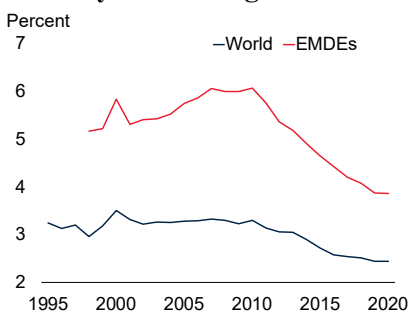
A. Global potential growth



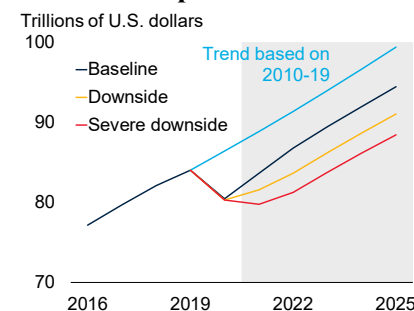
B. EMDE potential growth



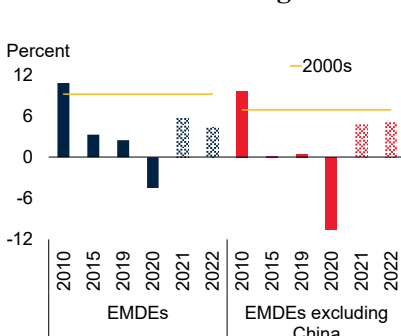
C. Ten-year-ahead growth forecasts



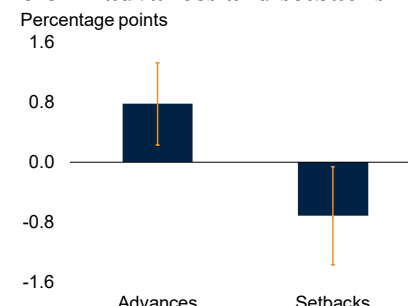
D. Global output levels



E. EMDE investment growth



F. Long-term growth forecasts five years after reform advances and setbacks



Sources: Consensus Economics; Haver Analytics; International Crisis Risk Group (database); Kilic Celik, Kose, and Ohnsorge (2020); World Bank.

Note: EMDEs = emerging market and developing economies.

A.B. GDP-weighted average (at 2010 prices and exchange rates) for 82 economies, including 52 EMDEs. Potential growth estimates are based on a production function approach as described in Kilic Celik, Kose, and Ohnsorge (2020). “Pre-COVID,” “Post-COVID,” and “Reforms” are defined in chapter 3.

C. Aggregate GDP growth calculated using GDP at 2010 prices and market exchange rates as weights. Results from the latest Consensus Economics surveys in each year are presented. Sample includes 84 countries, including 51 EMDEs.

D. Data are in U.S. dollars at 2010 prices and market exchange rates. Shaded area indicates forecasts. Trend and baseline output, as well as the downside and severe downside scenarios, are described in chapter 3.

E. Aggregate growth is calculated with investment at 2010 prices and market exchange rates as weights. Sample includes 63 EMDEs. Shaded bars indicate forecasts.

F. Cumulative impulse responses of ten-year-ahead growth forecasts on reform advances and setbacks after five years since the beginning, based on local projection estimations for 57 countries during 1990-2020. Vertical orange lines show the 90 percent confidence intervals. Reforms are defined in chapter 3.